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ABSTRACT

This document represents the completion of the first phase of a study of adult and continuing education in California. The current method of funding community colleges in general, and adult/continuing education programs offered by community colleges and school districts specifically, are examined, their shortcomings noted, and alternatives to the present method of funding suggested for consideration and legislative adoption. The report recommends replacing the current Foundation Aid Program with Percentage Equalizing as the way to finance adult/continuing education in the state. The proposed changes would eliminate the present "enrollment cap", would achieve equal expenditure per pupil and equal tax effort per taxpayer throughout California, and would generally simplify community college and adult school financing while constraining public expenditures for community colleges and adult education to a level consistent with increases on tax revenues. Detailed analysis of the current financing system and the proposed system constitutes the bulk of the report. (Author/JDS)

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BRIEF

Agenda Item 8
February 9-10, 1976

Agenda Title: Adult School and Community College Finance

Action Item

Summary:

The document which follows entitled: "Adult School and Community College Finance," represents the completion of the first phase of a study of adult and continuing education in California, adopted as a priority area of concern by the California Postsecondary Education Commission in April 1975.

The changes proposed in this report would eliminate the "enrollment cap" which was placed on adult schools, Community Colleges, and Regional Occupation Programs and Centers with the adoption of the Fiscal Year 1976 Budget by the California Legislature.

The changes proposed would replace the current Foundation Aid Program with Percentage Equalizing. The adoption of Percentage Equalizing would be an important step forward in achieving equal expenditure per pupil and equal tax effort per taxpayer throughout California.

Percentage Equalizing would greatly simplify Community College and adult school financing by eliminating the necessity for such outdated terminology as defined adult, other-than-defined adult, computational tax rates, full-time and part-time student. Percentage Equalizing would provide local school districts with a high degree of budgetary predictability, while constraining increases in public expenditures for Community Colleges and adult education to a level consistent with increases in tax revenues.

The report is the product of extensive consultation with all segments of postsecondary education. Special emphasis has been placed on consultation with representatives of various districts of the California Community Colleges and the adult schools.

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Further reports reflecting other aspects of adult and continuing education will be submitted for consideration at subsequent meetings of the Commission in 1976.

Recommended Action:

Adoption of the report.

California Postsecondary
Education Commission

February 9-10, 1976

# ADULT SCHOOL AND COMMUNITY COLLEGE FINANCE

## I. Introduction

In April, 1975, the California Postsecondary Education Commission designated adult education as a priority problem that required prompt consideration. Consequently, Commissioners and staff have devoted considerable time to deliberating this important issue.

The recommendations contained in this report are based on substantial research and on extensive discussion with adult school and Community College administrators at the local and statewide level.

The Legislature's adoption of the "5 percent cap" on State support in the 1975-76 Budget intensified the interest in comprehensive reform of adult school and Community College finance. This report focuses on the causes for, consequences of, and alternatives to the cap.

Certain aspects of the adult education problem require further study by the Commission and the segments of postsecondary education. The issue of reorganizing adult education in California is complex and will be addressed in subsequent meetings of the Commission. In addition, the following areas should be considered in further detail and included in a study of Community College finance to be completed in December 1976:

1. Enrollment Measurement: Would the adoption of the Full-Time-Equivalent measurement facilitate the budgetary and program planning process? If not, how should we count students in Community Colleges and adult schools?

2. Differential Funding: It may be desirable to vary the percentage of State support to reflect a greater or lesser State interest in personal competency and vocational courses.

3. Tuition: Should tuition be considered as one source of financing Community Colleges and adult schools

4. Special Aid: Should additional aid or services be provided for students who are low-income, non-English speaking, educationally disadvantaged, or physically handicapped?

5. Capital Outlay: Is the current capital outlay procedure consistent with other existing or contemplated financing practices?

6. Labor-Market Demands: Can the availability of certain courses be more related to the demands of the labor market?

The objectives of the recommendations proposed for adoption at this time are:

1. The system of State support for adult education must be consistent with the budgetary constraints which prompted the cap.

2. The patchwork of terms--defined and other than defined adult, computational tax rates, foundation program rates, part-time and full-time--must be eliminated.

3. The process of equalizing expenditures per pupil and tax effort per taxpayer throughout the State must continue.

4. The system of State support must reflect changes in the economy as faced by the State and local districts.

5. The system of State support must provide local districts with a substantial degree of budgetary predictability.

6. Changes in financing adult education in unified and high school districts must be consistent with changes affecting Community Colleges and Regional Occupational Programs and Centers (ROP/C's).

Based on these six conditions, a system of percentage equalizing should be adopted for Community Colleges and adult schools which would replace the current foundation program. Expenditures per unit of average daily attendance (ADA) would be established at the level of the current revenue limit for Community Colleges. Expenditures per unit of average daily attendance would be established at the level of current expense of instruction for adult schools. Local contribution per ADA would be based on the district's wealth relative to the modified assessed value per ADA statewide.

Categorical-aid programs which now provide additional State support for programs such as EOPS should remain in effect pending the completion of the Community College Finance Study in December 1976.

Students not regularly enrolled in compulsory education (K-12) would be permitted to enroll in Regional Occupation Programs and Centers only on a contractual basis and through a Community College or adult school. The student would generate ADA for the Community College or adult school just as any other regularly enrolled student, rather than for the ROP/C, as is the current practice.

Average daily attendance units generated in courses designated as "recreational/avocational" would not be counted in ADA for purposes of State support. This designation would be made by the Board of Governors and the State Board of Education and based on a taxonomy developed by the Postsecondary Education Commission and the State Department of Finance. Such courses could be supported through local tax efforts and user fees.

The changes recommended in this report should become effective with the adoption of the Fiscal Year 1976-77 Budget. However, should certain items in the proposal require extended discussion prior to adoption, a plan for phased implementation should be developed by the Legislature, Department of Education, the Chancellor's Office, Commission staff, and other organizations involved with continuing adult and continuing education.

The cap should be replaced by a constrained revenue schedule that would reflect shifts in the economy, lead to more modest increases in State support, and provide the local districts with a mechanism which is highly predictable for budgetary considerations. The progress toward equal expenditures per student and equal tax effort per taxpayer are highly desirable objectives; percentage equalizing would insure continued orderly progress toward these objectives.

## II. Limited Public Resources

Nearly everyone recognizes that some kind of limitation on the State's spending for Community Colleges and adult education is inevitable. This inevitability is, in a large part, explained by certain characteristics of the cyclical performance of state and local governments. Both usually follow the swings of the business cycle, spending and building in a period of prosperity and contracting their activities during a recession. That is, the taxing, borrowing, and spending activities of these governments tend to run counter to an "economically sound fiscal policy."[1]

California is no exception. Indeed, the constitutional and statutory requirements for a balanced budget, plus the limited ability of governments below the federal level to obtain credit, compel the State to follow the business cycle from peak to trough.

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1. Alvin H. Hansen and Harvey S. Perloff, State and Local Finance in the National Economy; (Norton, 1944) p. 49.

Student demand for postsecondary education is also linked to the business cycle. Other things being equal, when the economy is healthy and unemployment rates are low, demand for postsecondary education is low.[2] When the economy is shaky and unemployment rates rise, student demand increases. This is a fairly well understood (although somewhat unpredictable) phenomenon. As the unemployment rate rises, one of the major costs to the student of participating in postsecondary education drops--his foregone earnings, or the income lost being enrolled in postsecondary education.

The current situation in the State illustrates this point. The rate of expansion of real State revenues have slowed dramatically, while at the same time enrollments in both publicly supported and independent institutions have increased rapidly. Enrollments at the University of California are up 5 percent; at the member institutions of the Association of Independent California Colleges and Universities, and at the California State University and Colleges nearly 6 percent; and at the California Community Colleges 15 percent. These increases are two and, in some cases, three times higher than even the best enrollment projections of a few

From the standpoint of State finance, the effect of the economy upon enrollments is rather perverse. At the same time the State is seeking to limit its activities, its postsecondary education obligations are increasing. Simply stated, the predicament of the State is that it presently lacks the financial resources to satisfy all of its postsecondary wants, preferences, and commitments. The solution to this predicament lies in bringing the State's financial means and its postsecondary commitments into line with each other.

## III. Current Community College and Adult School Finance

In seeking such a solution, budget analysts should look first to the Community Colleges and the adult school programs of high school and unified school districts and the Regional Occupational Programs and Centers. It is in these segments where enrollments are increasing most rapidly; where State expenditure is tied by statute directly to these enrollments; and where, because of the design of existing funding formulas, the State is committed to supporting an increasing share of the total costs generated by enrollment growth.

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2. Note that we are talking about the short run. In the long run, student demand may be expected to increase as a positive function of the rate of expansion in the economy as a whole. See Stephen Dresch, Education Saturation: A Demographic-Economic Model; December 1974.

The statutory, enrollment-driven mechanism for financing Community Colleges and adult schools is the crux of the State's predicament. Where the University of California and the State University and Colleges are concerned, enrollment is estimated a year ahead of time and the budget fixed. If more or fewer students actually show up, the budget is unlikely to be affected immediately. One might say either (1) that the budget constraint operating in these segments serves to constrain enrollment, or (2) that average cost per student is made to fluctuate automatically with the level of enrollments.

Either way we choose to look at the situation, the problem of bringing the State's means and commitments into line is easily solved by the budget process. The problem with this approach is that by divorcing funding levels from enrollment levels, we reduce the senior segments' incentive to compete for State dollars by competing for students, thereby reducing the incentive to respond to the legitimate interests and preferences of prospective students.

The situation is just the reverse with the Community Colleges and other "adult education" programs. Public support is tied directly to full-time-enrollment levels. For the district, each additional unit of average daily attendance (ADA) generates the same number of dollars as each preceding ADA. This provides considerable incentive to the district to respond to student preferences, to efficiency, and to innovation. However, this mechanism puts the State's commitment directly at odds with its means.

An explanation that this is the case requires some elaboration of the present system of Community College and adult education finance. There are three elements of this system which must be understood: (1) the relationship between enrollments and cost--the total cost schedule, (2) the relationship between enrollments and revenues--the revenue schedule, and (3) the relationship between enrollments and the State's share of Community College and adult education support.

## A. The Total Cost Schedule

We assume that, other things being equal,[3] a district increases enrollments by providing services which increase the benefit or

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3. By other things being equal, we mean that the environment of the student and the district do not change: that prices are stable, the district population does not vary in size or composition, that the costs and benefits of participation in alternatives to school are stable, and the rules by which enrollments are counted do change.

reduce the cost to the prospective student of enrolling in an adult school or Community College program or course. That is, the district may increase enrollments by offering more course titles, or degree and certificate programs which interest students, better job training or preparation for transfer to a four-year college, more stimulating instruction in the classroom and class laboratory, smaller class size, more locations at which courses and degree programs are offered, or better counseling to assist the student in matching his talents and interests to the district's offerings. These additional provisions cost money, and beyond some point we conclude that the district can increase enrollment only at an increased cost per ADA.[4]

## B. The Revenue Schedule

A major innovation of SB 6 and SB 90 was to replace local tax-rate control with local revenue control, thereby tying most district revenue directly to enrollment. The mechanism through which this operates is the revenue limit, which establishes the maximum per ADA amount the district may earn from the State and local property taxpayers. Most districts choose to earn nearly the full amount authorized by the revenue limit. This means that the district's revenue schedule is simply: total ADA times the revenue limit.

Given the preferences of actual and potential students, the effectiveness with which the district responds to their preferences, and the constraint that total expenditures must be less than, or equal to, total revenue, the revenue limit will determine the spending of the district and, by aggregation, total spending statewide.

## C. Enrollment and State Aid

The State's share of a district's revenue is determined by a fairly complex mechanism known as the Foundation Program. This program has two components: Basic Aid and Equalization Aid. Basic Aid is a flat per ADA grant of $125, regardless of the wealth of the district.

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4. This means that if enrollments are the output with which we are concerned, then the relevant cost faced by the district is the cost of enrolling an additional student and we can post cost curves which exhibit the properties usually assumed by economists; total cost is a cubic function of enrollment; average total cost, average variable cost, and marginal cost are all second degree curves which first decline and then increase as output is expanded. See "A Market Model of Community College Finance," p. 14.

Equalization Aid is derived by means of a simple formula with the following variables: a computational tax rate (r); the district's assessed valuation (A); estimated ADA (E); and the foundation program amount (F). Where: $F - [r\ (A/E) + \$125] > 0$, the following formula holds: Equalization Aid = $(FE) - (r\ A + \$125\ E)$, and total State aid is equal to Equalization Aid plus Basic Aid. In theory, Equalization Aid tends to equalize interdistrict differences in the amount of money available per ADA generated by similar local tax efforts.[5]

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5. This mechanism is, in principle, elementary, but in practice it is complicated by:

   1. The fact that each district has a different revenue limit and assessed value; and

   2. There are two Foundation Aid amounts and two computational tax rates, one corresponding to "defined adult" ADA and one to "other" ADA; (this is so despite the fact that from the standpoint of the revenue limit both kinds of ADA are equal).

   To determine its tax rate for current operations, a Community College District must:

   1. Estimate its total assessed valuation;

   2. Estimate its defined adult ADA;

   3. Estimate its "other" ADA;

   4. Estimate total revenue (total ADA multiplied by the revenue limit);

   5. Compute State aid for "defined" adults based upon a foundation amount of $637 and a computational tax rate of 24¢;

   6. Compute State aid for other students based upon a foundation amount of $1,143 and a computational tax rate of 39¢;

   7. Determine total State aid by summing 5 and 6;

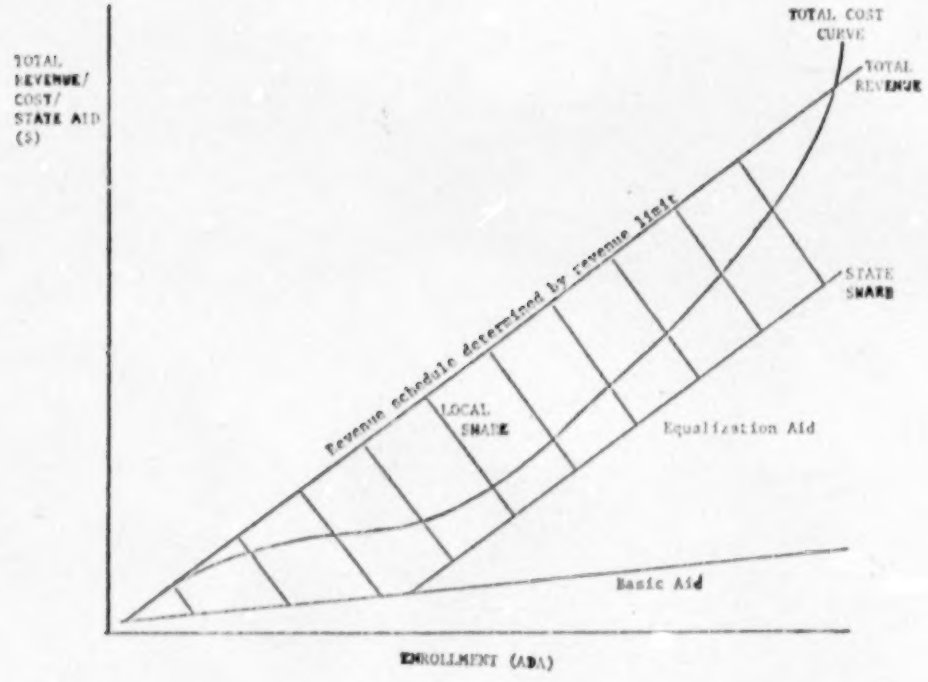
   8. Subtract 7 from 4 to determine local share; and

   9. Divide 1 into 8 to produce the local tax rate.

   Statewide, this process results in an average tax rate of 57¢ per $100 assessed valuation. However, local district tax rates vary from 29¢ to $1.10.

The interaction of cost and revenue schedules and the Foundation Program are illustrated in Figure 1.[6] Both the district's total revenue and its enrollment level are determined by the intersection of the cost and revenue schedules. The State share is determined by the enrollment level; hence, the State share and total State aid are determined by the cost and revenue schedules.

Figure 1
Local District Cost and Revenue Schedules

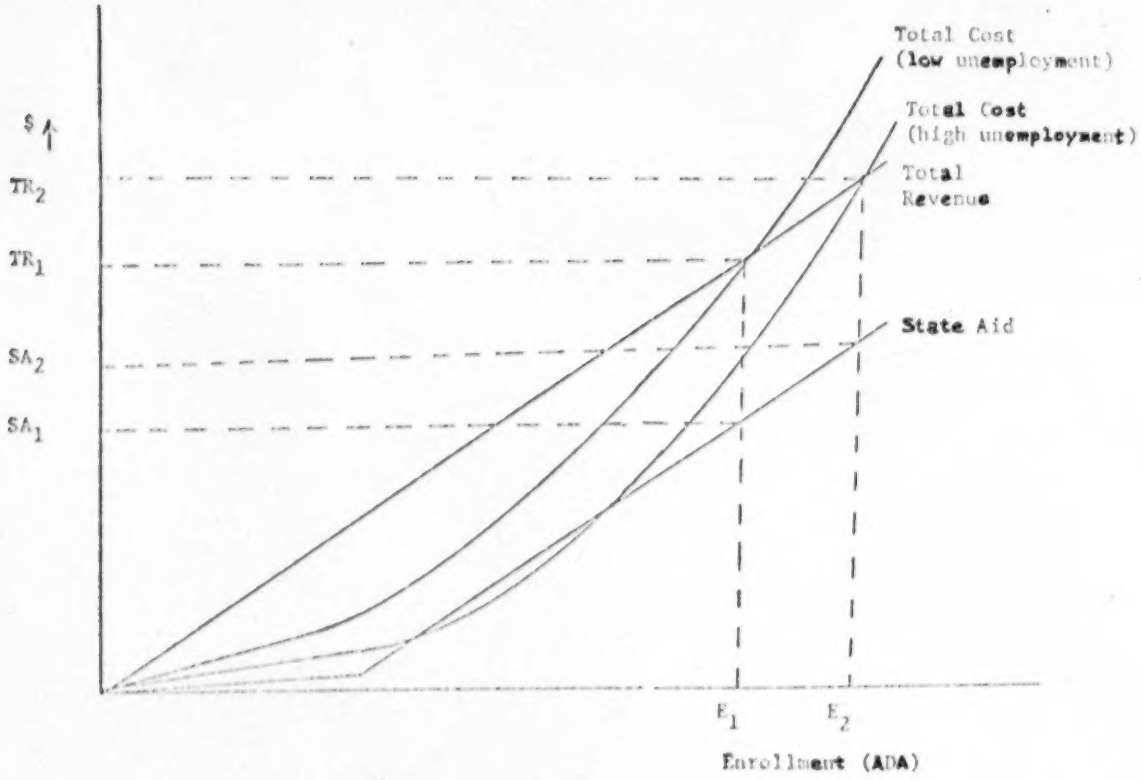



6. Note that in this case the revenue limit is identical to the Foundation amount; this means that up to the point at which the district becomes eligible for Equalization Aid, most of the marginal revenue generated per ADA is provided by the local property tax; beyond that point 100 percent comes from the State. It is unlikely that this conforms to the specific circumstances of any district in the State. The actual distribution of responsibility for a district's marginal revenue will depend upon the district's revenue limit and the kind of student enrolled, but generally the point illustrated here will hold: other things being equal, the State's share increases with enrollment.

Now what happens in our hypothetical district when the health of the economy changes so as to reduce the student's cost of participating in postsecondary education? The effect of this change is seen in the total cost curve. Just as inflation will shift the cost curve to the left and upward, unemployment will shift it down and to the right. That is, even if the district hires no more faculty, offers no more course sections or programs, acquires no new books, or builds any additional classrooms, more students will enroll if unemployment rises. The consequences of such a change are illustrated in Figure 2.

Figure 2

The Effect of Increasing Unemployment
Under the Existing System of
Community Colleges and Adult School Finance



Note that in this illustration as ADA increases ($E_2 - E_1$) the increase in total revenue ($TR_2 - TR_1$) is proportional to the increase in ADA, and the increase in total revenue will be provided by State aid ($TR_2 - RT_1 = SA_2 - SA_1$). This illustration should make clear how the funding mechanism presently supporting the operations of Community Colleges, adult schools, and Regional Occupational Programs and Centers places the State's commitment directly at odds with the State's means.[7]

## IV. Alternative Solutions

What is the solution to this dilemma? There is not one solution, but several--each possessing relative advantages and disadvantages. The first which comes to mind is the adoption of a system of State-level budget review and implementation similar to that which governs the funding of the University of California and the California State University and Colleges. The principle advantage of this approach is that it would greatly increase State-level control over Community College and adult education expenditures, thereby making it possible to tailor the State's obligations to fit its anticipated means. The disadvantage of this approach lies in the fact that it would weaken the link between enrollment and revenue and, consequently, the incentive to respond to the interests and preferences of both actual and potential students.

## V. The Revenue Cap

The second solution is the one the Legislature adopted this year, the revenue cap. Under the cap, the Legislature intended that State support be limited to a 5 percent increase in ADA over the 1974-75 enrollment level. However, a district is authorized (under both SB 6 and SB 90) to make up the difference between State support and the amount of the district revenue limit.

This solution clearly establishes the State's obligation; moreover, it has the advantages of permitting, at the discretion of the district board, the full expansion of enrollment up to levels established by the district's revenue limit and its cost schedule. The operation of

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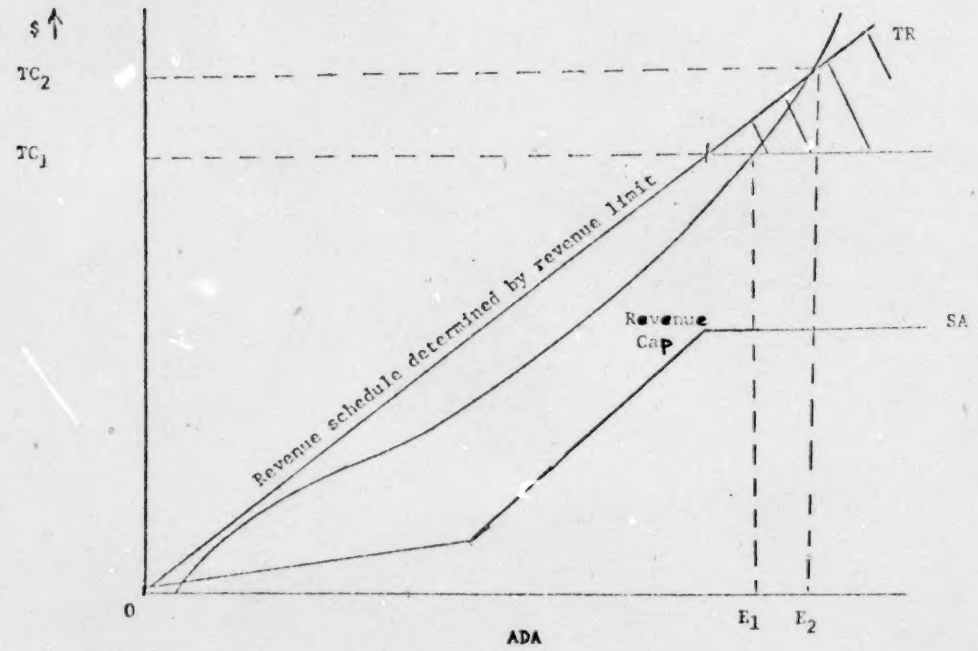
7. Of course this is a simplification of reality. We have already noted some of the limits of this illustration. (See Footnote 5, page 7.) Furthermore, the effect of unemployment can be expected to be offset by inflation, but only to the extent that revisions in revenue schedules fail to account for this factor.

the revenue cap is illustrated in Figure 3. This illustration shows that our hypothetical district would enroll $E_1$ at a total cost of $TC_1$ if it did not choose to pass on to the local taxpayer any additional amount authorized under the revenue limit. On the other hand, it could enroll up to $E_2$ by taxing up to the authorized amount.

Figure 3

Enrollment and Revenue Consequences of the Cap




The effect of the cap has been threefold: (1) State expenditures have been controlled, (2) enrollments have been constrained somewhat, and (3) Community College and adult school support has been shifted somewhat to local taxpayers. These effects are illustrated by Community College enrollments and expenditure estimates developed by the Department of Finance (DOF) and the Office of the Legislative Analyst (OLA).[8]

8. "Presentation to the Assembly Education and Senate Education Joint Committee hearing" by Charles E. Gocke, Program Budget Manager, Education Systems Unit, Department of Finance, November 6, 1975; and statement of Office of Legislative Analyst, State of California, to the Assembly and Senate Education Committees, Sacramento, November 6, 1975.

According to these sources, the revenue cap produced an estimated saving to the State of $83.1 million. Actual 1975-76 Community College enrollments (ADA) are estimated to be 765,342; had there been no cap it is estimated that enrollment would have reached 803,000. If all districts had decided to live with capped revenue amounts, it is estimated that enrollment would have reached 742,140 (DOF) or 723,500 (OLA). (Commission staff is inclined to accept the higher DOF estimate.) Finally, local property taxes have increased by about $16 million over what they would have been without the cap. One interpretation of the figures suggests that the total savings to the people of California as a result of the cap was roughly $65 million, at a cost of roughly 35,000 ADA or a savings of $1,850 per ADA not enrolled.

The State revenue cap has been criticized as simply shifting support of Community Colleges and high school adult education from the State's General Fund revenues back to local property taxes. The figures provided above suggest that this allegation is somewhat unfair. The cap does considerably more than that. Furthermore, this allegation implies that General Fund revenues are better or fairer taxes than property taxes. Recent research, however, has challenged this idea. Given adequate tax relief to low income homeowners, it appears now that property taxes are moderately progressive. The same cannot be said for a number of State taxes--in particular, the sales tax--the tax which traditionally has been increased to provide the increases in State school support.[9]

The disadvantages of the revenue cap are subtle. If it is assumed that the public interest lies in equalizing local tax effort for Community Colleges and maximizing postsecondary education participation--subject of course, to a budget constraint--then the revenue cap is a relatively unattractive alternative. The cap has the effect of reducing the expansion of postsecondary education opportunities in an uneven manner. Its adoption has meant that high income/high wealth districts will continue to expand enrollments at present rates, while low income/low wealth districts are severely constrained. The objective of maximizing participation requires that resources be distributed so that the last dollar allocated will generate an equal

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9. See Dick Netzer, "The Incidence of the Property Tax Revisited," National Tax Journal, XXVL (December 1973), pp. 515-35. Morton Paglin and Michael Fogarty, "Equity and the Property Tax: A New Conception Focus," National Tax Journal, XXV (December 1972), pp. 557-65. Allen Odden, "Is the Property Tax Progressive? A Potential Threat to School Finance Reform," Compact (October 1975), pp. 7-10.

amount of student enrollment wherever it is allocated. Conversely, we are saying that we should maximize the savings to the taxpayer per ADA not enrolled. This objective is approached as revenue for each ADA added is equalized between districts. Unfortunately, the cap has the effect of maintaining or even widening marginal revenue differences between districts.

Many proponents of the cap acknowledge these problems, but contend that it is the only practical alternative available to the Legislature at this time. Further, it is suggested that it is an interim measure, adopted to deal with an immediate problem, and should be discarded as soon as circumstances permit.

The second argument is clearly in error; without a fundamental change in the Foundation Program, the cap has the effect of building in ever-larger costs of removal, which will not decrease with time. We are told, for example, that removal of the cap in 1976-77 would cost the State $167.2 million and that "in view of the enormous potential cost. . .it is obvious that the 'cap' will have to be continued until some type of changes are made in [the] current adult program."[10] Moreover, the revisions in the Foundation Program that could reduce the cost to the State of discarding the cap appear to grow progressively more difficult with each year spent under the cap.

## VI. Constrained Revenue Schedules: A Sensible Alternative to the Revenue Cap

The preceding observation suggests a third solution to the State's fiscal predicament. It was pointed out earlier that a district's enrollment and total revenue is determined (or limited) by the intersection of its cost and revenue schedules. This means enrollment and total revenue can be limited by revising the revenue schedule downwards and to the right. Each year, some modification in revenue limits is made, primarily to deal with the effects of inflation. It would be just as easy to adjust revenue limits to provide for swings of the business cycle. This mechanism is illustrated in Figure 4. The illustration shows that if the revenue limit in our hypothetical district were revised ($TR_1$ to $TR_2$), then enrollment would fall ($E_1 - E_2$), and so would total expenditures ($TC_1 - TC_2$).

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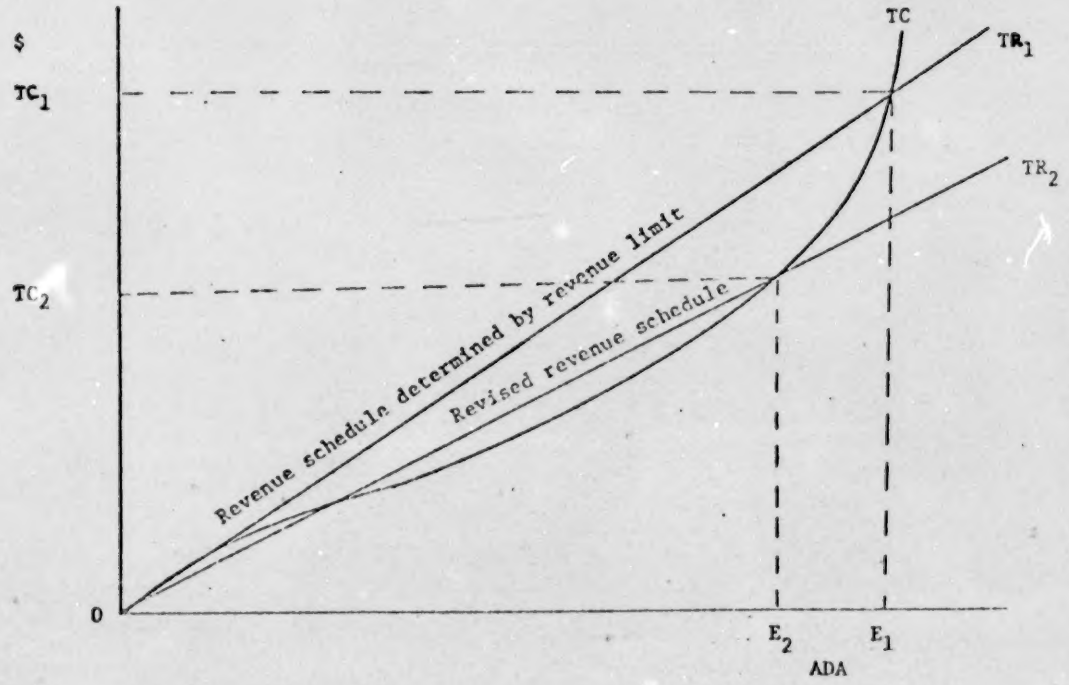
10. Gocke, Ibid.

Figure 4

The Enrollment Consequences
of a Constrained Revenue Schedule




VII. Percentage Equalizing

If the Foundation Program remained the mechanism by which the State's share of a district's revenue is determined, the control of State expenditures would require considerable revision of existing revenue limits. This is due to the fact that, under the Foundation Program, the State's share of a district's total revenue increases as enrollment increases, a flaw in the present system of finance which should be corrected if this third solution is to be adopted. The best way to accomplish this objective is to discontinue the Foundation Program and adopt percentage equalization.

Percentage equalizing provides the State with the opportunity to establish a level of commitment that is easily understood. Under percentage equalizing the Legislature would make two decisions: (1) it would establish appropriate district revenue schedules; and (2) it would select the desired percentage of State support. The first decision would determine the total level of enrollment and

operating revenues. The second would determine a fixed proportion of the total operating revenues which the State would provide. Compared with the present system, the improvement in comprehension and State-level predictability offered by this method is substantial.

For the individual district, the percentage of the State's share would be adjusted by a rate expressing the wealth of the district relative to that of the average district in the State. The adjusted percentage would then be applied to the revised revenue limit to derive the level of State support per ADA.[11]

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11. Percent Equalizing and its Application for Specific Community College and adult school districts

The percent equalizing equation is the following:

$$\text{State Aid/ADA} = (\text{Revenue Base/ADA} (1 - [K \frac{\text{District AV/ADA}}{\text{State AV/ADA}}]))$$

For example: See Marin Illustration below:

K = An established percent of local support.
The Revenue Base/ADA for community colleges = The Revenue Limit as established by SB 6.
The Revenue Base/ADA for all classes offered by adult schools = The current expense of education as reported by the J-51.

The following table illustrates the specific effects of percentage equalizing, and is based on information supplied by the Department of Finance, the Chancellor's Office of the California Community Colleges, and the Office of the Legislative Analyst, and the assumption of a 50 percent State share:

MARIN: State Aid/ADA = $1,282 [1 - (.50 \frac{165,383}{110,470})]$

State Aid/ADA = $1,282 [1 - (.50 \times 1.497)]$

= $1,282 \times 0.2515$

State Aid/ADA = 322.42

Local Contribution/ADA = 959.58

The implementation of this proposal would require the use of actual ADA and assessed value for the year of budget appropriation in a manner similar to that now authorized under SB 6 and SB 90.

Percentage equalization has several other advantages. Because Basic Aid would be dropped, the adoption of percentage equalization would provide for more equal treatment of taxpayers. Furthermore, it would enable the State to abolish the categories of "defined adult" and "other than defined adult." If the Foundation Program were retained, at the minimum both a new computational tax and Foundation amount would have to be selected. In our opinion, the identification of an acceptable Foundation amount and tax would be extremely difficult. The most efficient way to accomplish this change is through percentage equalizing. The Board of Governors has for many years proposed the adoption of percentage equalizing for the Community Colleges, as did the former Coordinating Council for Higher Education. However, because percentage equalization would modify the relative wealth of local districts, the proposal has never received their full support.

## VIII. Establishing District Revenue Schedules

The critical decision which the Legislature will make is not the selection of the desired percentage of State sharing, but the revision of revenue schedules. How should this be done? Based on present concern with Community College and adult education financing, we find that an answer to this question must satisfy certain conditions:

1. A proper answer should bring the State's means and obligations into line with each other.

2. A proper answer should be efficient; it should provide us with a method of financing which will insure that we are providing the maximum access to postsecondary education with the dollars available.

3. A proper answer should neither contribute to inequality of expenditure per student (ADA) nor exacerbate inequalities in property taxes.

4. Because of the need for prompt action a proper answer should be predictable. To insure implementation in September 1976, whatever is proposed should be understood by those responsible for providing postsecondary education services at the local level.

5. Finally, a proper answer should be neither arbitrary nor destablizing in its effects, at either the State or district level.

We have observed that our present predicament is in large part explained by the perverse relationship between the economy, the State's financial resources, and enrollment levels. If this relationship is granted, then a fairly straightforward solution presents itself: index the level of public support to the health of the economy.

The most efficient method of implementing this solution would establish a specific amount of money, the size of which would vay with State and local revenue-raising capacities indexed to either net State Product or General Fund Revenue. Once the size was determined, it would be distributed to adult school and Community College districts on the basis of enrollments.[12] The positive incentives implicit in such a mechanism are clear. The certainty and control it offers to State-level planners and budgeters are unsurpassed by any alternative mechanism which would also provide efficiency incentives to district administrators. This mechanism has two practical alternatives:

1. Existing differences in per ADA revenue limits would complicate the allocation procedure. It might be possible to weigh the distribution of funds by existing revenue limits, however, it would be very difficult to accomplish this while reducing those differences. This, however, is not a technically insurmountable problem.

2. The "price" which would be earned by the district for enrolling a student (ADA) would not be known. This would create much uncertainty at the district level and greatly complicate the planning problems of the district.

We believe that the same outcomes can be achieved simply and in a reasonable manner under a second mechanism--one which would provide the benefits of a known revenue limit to the district

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12. This is essentially the Farrell-Andersen Growth Difference Formula for support of two-year postsecondary institutions adapted to the exigencies of support at the State and local level. See Robert L. Farrell and Charles J. Andersen, "General Federal Support for Higher Education: An Analysis of Five Formulas," in Mel Orwig, Financing Higher Education: Alternatives for the Federal Government. American College Program, 1971.

and, through improved planning at the district level, to the people of California. Under this alternative the revenue base per ADA would be calculated with reference to an index of State and local revenue raising capacities.[13]

The effect of adopting such an index would be the stabilization of both enrollments and revenues (expenditures).

How would this work? We would propose that the formula for the median per ADA revenue base (revenue limit) be determined by the following formula:[14]

76-77 median revenue base per ADA =

$$\frac{\text{Per Capita General Fund Revenue, 76-77}}{\text{Per Capita General Fund Revenue, 75-76}} \times \text{(75-76 median revenue limit)}$$

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13. Again, this is not a wholly original proposal. It has been proposed frequently that changes in revenue limits should be calculated with reference to an index such as the State and Local Government Services Implicit Price Deflator. See, for example, "Position Statement of the Board of Governors: 1976-77 Finance Program," December 4, 1975. We are simply proposing a further modification to account for additional changes in the environment of Community Colleges and adult schools.

14. In point of fact, this is not as easy as it sounds. Because local property tax rates must be set before the school year begins, it would be necessary to project this index ahead several months. Moreover, if indexing were to become a permanent feature of adult school and Community College finance, as is proposed here, true index numbers would have to be used. The State and Local Government Implicit Price Deflator is an example of a true index; but one would have to be designed to account for changes in per capita State revenue. Over the longer run this would argue for a projection formula with one of the following specifications.

A. $R_1 = R_o \left[ \frac{Y_1/Y_o}{Y_0} \right]$

or

B. $R_1 = R_0 + {}_1$ where: ${}_1 = \frac{Y_1 - Y_0}{Y_0}$

where: $R_i$ = Median per ADA revenue limit, year i

$Y_i$ = Per capita State General Fund Revenue, year i

This formula would mean that when real capacity to raise State and local revenue dropped, real revenue per student would also drop, thereby constraining enrollment growth.

If this proposal were to be implemented for the 1976-77 budget year, it would be necessary to go back two years to correct for the effects of the cap, calculate current year revenue limits, and then project forward to next year.

We assume that the State is committed to a policy of equalizing per ADA revenue bases. The mechanism by which this was to be accomplished, the "squeeze factor," has been negated by the adoption of the cap. We propose that it be reintroduced here and the following formula adopted:

Actual 76-77 increase in district revenue per ADA =

$$\frac{\text{76-77 median revenue limit}}{\text{75-76 actual district revenue limit}} \times (\text{76-77 median revenue limit} - \text{75-76 median revenue limit})$$

The effect of using this formula would be the gradual narrowing of the gap which now exists between the districts with the higher revenue limits and those with the lower revenue limits.

The outcome of combining percentage equalizing and the establishment of appropriate revenue schedules is fully predictable at the local level. Both the percentage share and the revised revenue limit would be known to the district. Its consequences in terms of State obligations might be less predictable than under either the State-level budget review alternative or the revenue cap, but its consequences for State budgeting purposes would be as predictable as State revenue, and would err in a direction consistent with the error in revenue estimation. This, after all, should be the real concern faced by those responsible for the public fisc--matching means with obligations.

Finally, if adopted, this proposal would have the effect of stabilizing the growth of both enrollments and total revenue at the district level, thus permitting more effective planning by the district. For these reasons, we would argue that this proposal is neither arbitrary nor capricious in its effects, and are prepared to endorse its implementation.

## IX. Implications for Adult School Finance

The proposals made here are intended to apply equally to both Community Colleges and adult schools. However, existing financial

support for adult education programs operated by high school and unified districts is entangled with the funding of the regular K-12 program. This means that if these proposals are to be adopted, either:

1. They must also be applied to the regular K-12 programs; or

2. The funding of adult programs must be disentangled from the funding of regular K-12 programs.

We shall concentrate our attention upon the second of these alternatives.

First, how does the district share its tax base under separate funding mechanisms? By eliminating the category of defined adult, which is relevant only to the adult program, ADA measurement is made wholly consistent between the regular K-12 program and the adult program. Since both the Foundation Program formula and the Percentage Equalizing formula employ the same term--assess value per ADA--it would be appropriate to use the same figure in both equations. That is, the district's assessed value would be divided by the sum of enrollment in the district, both the regular K-12 program and the adult program. At the State level, the ratio of assessed value per ADA in the district to assessed value in the State in the percentage equalizing formula would be based solely upon ADA in the adult program. That is, it would be weighted by the adult enrollment in the district according to the following formula:

$$AVA_S = \frac{\sum_{i=1}^{n} A_i \; AVA_i}{A_S}$$

Where:

$AVA_S$ = Average Assessed Value per Adult ADA, Statewide

$A_S$ = Adult ADA, total Statewide

$A_i$ = Adult ADA in district i

$AVA_i$ = Assessed Value per ADA (sum of regular K-12 program ADA and Adult Program ADA) in district i

Furthermore, separate funding mechanisms imply separate funds. For a number of reasons it is proposed that rules governing the transfer of funds between regular K-12 programs and adult programs should be tightened. However, if not accompanied by additional substantive

changes in revenue limits, this could cause considerable dislocation and distortion of existing programs. This is because a single revenue limit is not consistent with the present pattern of expenditures. Some districts spend considerably more per-adult ADA than authorized under the revenue limit; most spend considerably less.

This modification could be accomplished by a fairly simple and straightforward mechanism. Employing data found in Form J-51, new revenue limits would be based upon the reported pattern of expenditures in the district. It is recommended that appropriate changes in the K-12 revenue limit accompany any changes in the adult program to offset losses which might occur as a result of such changes.

Application of percentage equalization and the revenue-limit modification for Community Colleges and adult schools would utilize the same fixed percentage of State support and median revenue limit. Both of these are objectives to be achieved as soon as practicable. However, because of substantial differences in State contributions and revenue limits, it appears unrealistic that such changes could be achieved in the next fiscal year. Further, identical per-ADA revenue limit mechanisms imply identical enrollment measurement and accounting. Community College enrollment and accounting practices are quite different from those of the adult schools. Such practices must be standardized before proceeding with further equalization of revenue limits per ADA between adult schools and Community Colleges.

County operated ROP/C's are presently not financed under a Foundation Program of State and local support. Equal application of the proposals in this report would require support for such programs to be percentage equalized. The most efficient means of accomplishing this objective would be to include ROP/C enrollments in the ADA count--either adult school or Community College--under a joint powers agreement between the participating districts.

## X. The Issue of Public Priorities

The fiscal problems faced by the State during the past few years have produced a searching examination of our priorities. In particular, concern has been expressed that the State's commitment to providing postsecondary education services that allow an individual to pursue educational goals throughout life is far too open-ended. It would be a mistake to believe that the introduction of the revenue cap in the 1975 Session of the Legislature was not, in part, evidence of the extent of this concern.

The case for public support of postsecondary education must rest on the premise that (1) it generates substantial benefits which are not

captured by the individuals investing in their own human capital, and that (2) such education would not be supplied in sufficient amounts without government subsidies.[15]

We would continue to affirm that individuals should not be denied access to postsecondary education on the basis of age, sex, race, etc., but this does not mean that public support should be provided equally to all kinds of postsecondary education. For example, it has been argued by at least a generation of economists and educators that "general education," (basic education and personal competency, to use the categories below), produces benefits to the public at large in terms of less crime, a more informed citizenry, more efficient workers, and more competent consumers, as well as benefits to the direct recipient of the educational service. If this argument is valid, and considerable evidence can be found for it, then public support for general education is unquestionably justified.

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15. Public tax monies for direct support of such institutions can be justified only by the existence of public benefits associated with postsecondary education or by a social policy to redistribute income by raising the educational levels of disadvantaged citizens. Public benefits are those which accrue to society in addition to those accruing to individuals. A rational investment decision by an individual means the calculation of the costs and benefits to himself alone. But if other members of society benefit from an increase in a student's investment in education, they can induce him to undertake more education than he would on his own by offering him a subsidy. A direct grant to an educational institution so that the student will be charged a lower price is the principal public subsidy. The amount of subsidy should correspond to the value that society, exclusive of the student, receives from its incremental investment in postsecondary education.

    The total subsidy to an institution should be provided up to the point where the marginal social benefit resulting from one additional unit of education is equal to the marginal social cost of that unit. In calculating how large the subsidy should be, it is important to measure the amount of external benefits per student generated by higher education, because subsidies should be based on these externals. This is especially true if the bulk of the subsidies come from taxpayers who are not receiving the individual benefits.

    Unfortunately, these public benefits are very difficult to measure with any precision.

Justification for public support of vocational programs may be found in the pursuit of equal opportunity. It is not acceptable that a California citizen be denied the opportunity to better his occupation or status in life because of family income or assets.

At this point, however, it seems difficult to argue for the continued high level of public support for recreational or avocational courses. Nearly everyone acknowledges the inevitability of reducing the public commitment to recreational/avocational courses; the problem is how best to accomplish this objective. A major problem is that not everyone believes that these courses can be successfully distinguished from other courses.

In Fall 1975, the Program Evaluation Unit of the Department of Finance was requested to describe the courses offered in the area of adult education. In an attempt to introduce some standardization to the classification problem, the Department consulted with staff of both the Joint Committee on Postsecondary Education and the Postsecondary Education Commission. The taxonomy chosen by the Department of Finance was a shortened form of the course classifications proposed by the Postsecondary Education Commission, and provides for categories related to the purpose of the course. It included the following:

1. Adult Basic Education
2. Vocational Education
3. Personal Competency
4. Recreational/Avocational
5. Handicapped and Senior Citizens

The Department of Finance staff then analyzed the course offerings of 11 Community Colleges and 32 adult schools in the vicinity of those colleges, representing 18 percent of the ADA in Community Colleges and 31 percent of the ADA in adult school programs. In the overwhelming majority of courses, representing 80 percent or more of the ADA, there was little difficulty in course classification. In the remaining courses, staff surveyed over 5,000 students in order to ascertain their reasons for enrolling. In our opinion, the results of this survey strongly suggest that a course taxonomy can be established, maintained, and its operation monitored through post-audit.[16]

16. The Community Colleges and the adult schools in their vicinity were selected to provide a cross-section of California by such characteristics as race, income, geographical location, and size of school.

The implementation of the course taxonomy and the assignment of all courses to a specific category, procedures for assignment of new courses to a category, and the method of post-audit should be the primary responsibility of the Board of Governors of the Community Colleges and the State Board of Education. However, to insure parity and consistency of effort, the California Post-secondary Education Commission and the Department of Finance should be substantially involved in any such project.

There is considerable disagreement regarding the most efficient means of modifying existing financing mechanisms to reduce public commitment to the support of recreational/avocational courses. We propose that enrollments in these courses simply not be counted for ADA purposes; however, we would stress that this be accomplished at no loss (or gain) to the district in terms of current revenue. This could be accomplished fairly easily through appropriate revision of the district revenue limit. Districts could, and in most cases would, continue to offer these courses; however, there would be no revenue incentive to encourage an increase in their number. This proposal is not intended to mean that districts should be denied the opportunity to support the expansion of these courses through student fees or the community service tax. over, if the budget constraint created by this proposal were so severe as to thwart legitimate community interests, the revenue limit could be revised by the voters of the district.

## XI. Summary of the Commission Proposal and Its Potential Effects

In this report we have offered a program for reform of adult education and Community College financing which has many advantages over the more temporary solution of the revenue cap. Under this program:

1. The Foundation Program is replaced by percentage equalizing, eliminating Basic Aid;

2. Total State funding is guided by increases in ADA with a fixed percentage of State contribution;

3. Revenue base per workload unit is the current revenue limit per ADA adjusted in subsequent years to reflect:

   a. Changes in State revenue;

b. The squeeze factor, in which revenue limits above the State average receive a smaller increase than revenue limits below the State average; and

c. State and Local Government Services Implicit Price Deflator.

4. State share of local district revenue per workload unit is wealth equalized;

5. Category of "defined adult" is eliminated;

6. Elimination of State funding for courses whose primary function is recreational as defined by the Board of Governors and the State Board of Education; in consultation with the California Postsecondary Education Commission, the Department of Finance and representatives of local districts; and

7. Students not regularly enrolled in compulsory education (K-12) would be permitted to enroll in Regional Occupational Programs and Centers only on a contractual basis and through a Community College or adult school.

To estimate the effect of this proposal upon adult education and Community Colleges if our proposal had been adopted for this current fiscal year, we have compared it to the impact of the revenue cap. It should be understood that no one is yet sure of the effects of the cap. Estimating the precise effects that would occur under a different funding mechanism is very difficult.[17] But we calculate that the increase in the median revenue limit under our proposal would have been a little more than 50 percent of that actually authorized by the Legislature. Total enrollment would have been 780,000 (ADA) and at a State share of 40 percent (equivalent to 43 percent in the percentage equalizing formula), expenditures would have been $382 million--about the same as under the cap--and local expenditures about $20 million more. As opposed to the situation without the cap, implementation of this proposal would have meant a savings to the people of California of roughly $45 million, at a cost of approximately 20,000 students (ADA) not enrolled; that is a savings of $2,250 per ADA, about $400 more per ADA than under the cap.

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17. Abba P. Lerner, "Employment Theory and Employment Policy," The American Economic Review, May 1967, Vol. LVII, No. 2, pg. 1

At the local level, the quantitative effects of the proposals in this study would vary in magnitude, based upon the following factors: (1) a district's relative wealth per ADA as it compares to the State average; (2) the amount of its revenue limit; (3) the number of ADA enrolled in avocational/recreational courses; (4) the number of defined adults; and (5) the ratio of equalization and Basic Aid.

We recognize that some districts would be required to adjust expenditure levels downward. However, the advantages of (1) eliminating the category of defined adults, long considered a highly desirable objective of comprehensive school finance reform; (2) continued progress toward equalization of expenditures and tax burden throughout the State; and (3) establishment of an automatic adjustment to the revenue limit which is directly attached to fluctuations in the economy are felt to be positive changes that clearly outweigh any short-term negative effects of this proposal.

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